RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

LETTER 1031 **Nov. 29, 1989**

DEVELOPMENTS: (1) Fundamental: There hasn't been much publicity about it, but the secret is out. It seems the economy is weakening rather dramatically. Who says so? The *New York Times* (Nov. 20) on its front page -- clip below:

> ***U.S. Economy Shows Signs of Broad Slump***
>
> As nearly every new statistic demonstrates, the economy is suffering from a severe downturn, perhaps the worst of the last seven years. The economy has bounced back quickly from two earlier slumps during seven consecutive years of economic growth, and most economists speak of a similar revival this time. But there is an undertone of uncertainty in their reassurances.

(2) Wall Street: "When coming events cast their shadows before, those shadows fall on the New York Stock Exchange." Thus wrote WSJ editor William Hamilton in 1926. The "shadows" are falling on Wall Street now. Since 1987, 24,000 brokerage house employees have exited the scene. Drexel has just cut its junk bond staff by 11%. Salomon Bros. has let hundreds go. Shearson will fire at least 800 and will also cut brokers' commissions; Merrill Lynch will be cutting back. The 200 million share days on the NYSE are a memory now. Volume tends to shrink in bear markets.

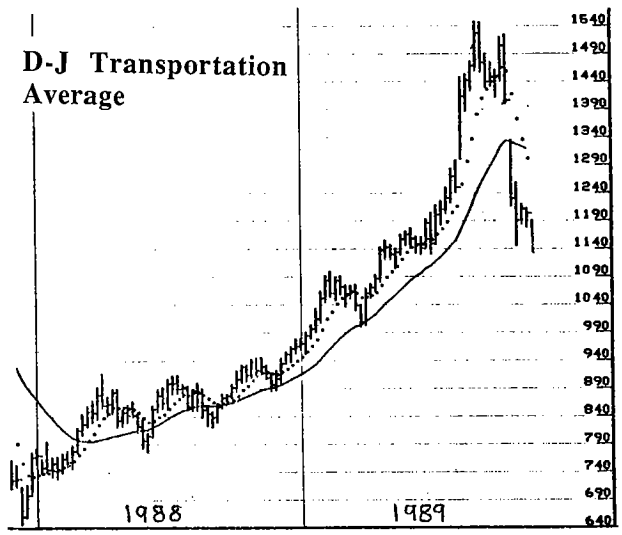
(3) The latest Consumer Price Index figure shows a jump of 0.5% for October (biggest rise since last May) for an annualized inflation rate of 6%. Fed Chairman Greenspan wants zero inflation. We're uh -- waiting (personally, I think the economy would collapse with zero inflation).

(4) The stock market doesn't seem to know whether to react to the almost unanimous predictions of lower interest rates ahead -- or the less recognized perception that the US economy is going into the tank. My friend, Joe Granville, in his November 16 mailing reports that "435 Big Board stocks are now within a point or less of making new 12-month lows." That's a huge negative, and it means one thing -- the bearish potential is increasing.

(5) As my veteran readers know, the surest action in the stock market is the almost automatic retracement of 50% or more -- following a true market crash. Four days after the October 13 market crash the Industrial Average had recovered better than half its losses. The Transports, however, hardly budged higher. This is most unusual, particularly in view of the violence and extent of the crash in the Transportation Average. On November 20 the Transports broke to a new post-crash low. If the Transports are as weak as they seem to be -- then the bull market is over.

The technical pattern in the Transportation Average is now rather dramatic. This weekly chart (courtesy of *Mansfield*) shows the huge gap-break in the Transports. The carrier average has plunged well below its moving average (and note that the moving average has now turned bearishly down).

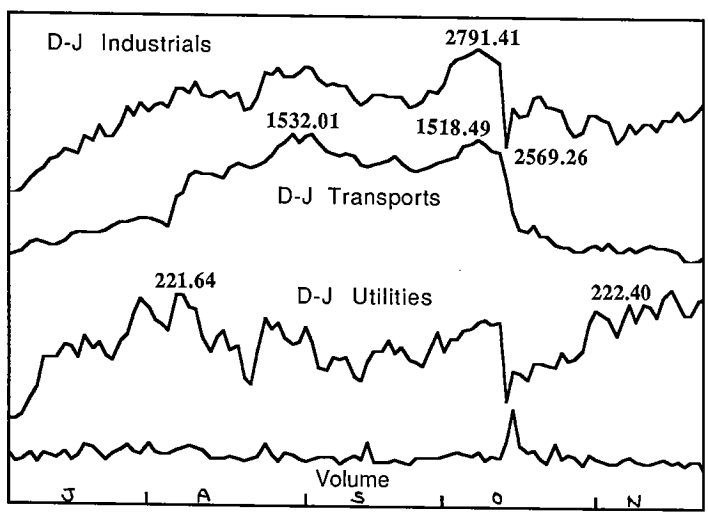
Nov. 17 DJIA 2652.66; PTI 3270; A-D Ratio -7.69
Nov. 24 DJIA 2675.55; PTI 3275; A-D Ratio -7.65
Dow Yield: 3.97%; Dow P/E: 11.5; DowPow: 604
Dow Book Value: 1075; Dow 200-day MA: 2526
Percentage of Undervalued Blue-chips: 17%

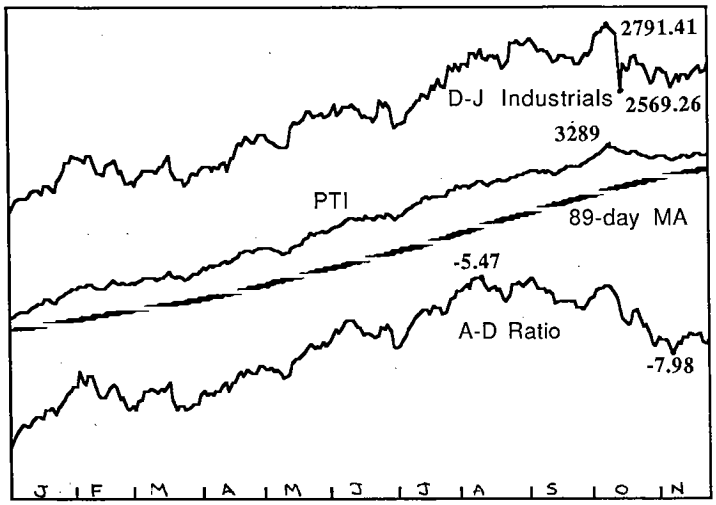


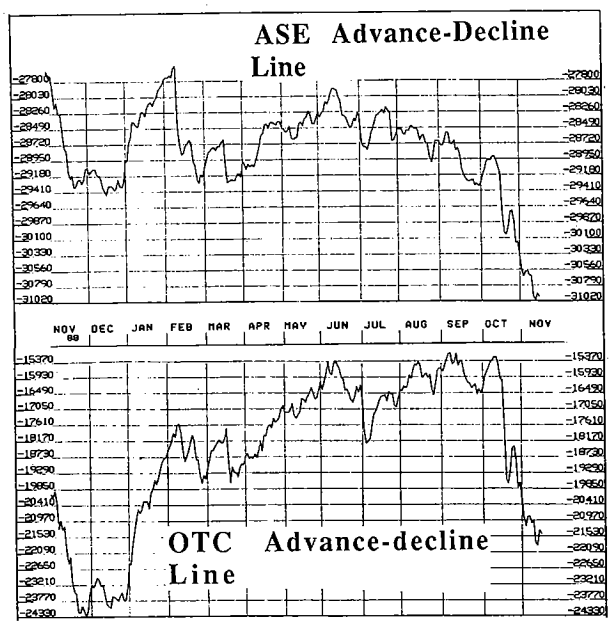
(6) The damage on the AMEX and the OTC has been considerable, as seen in the collapse of their respective advance-decline lines (charts courtesy of *Mansfield*). The AMEX has now wiped out all of its gains of 1989 and more (see page 2 charts).

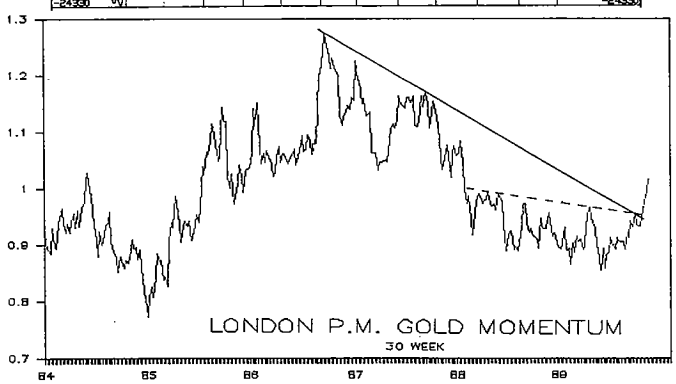
(7) Inflation is rising in both Europe and Japan. This is putting upward pressure on overseas interest rates. Japanese and major European rates are now inverted (i.e., short rates bearishly above long rates). German short rates at 8.5% are higher than US short rates.

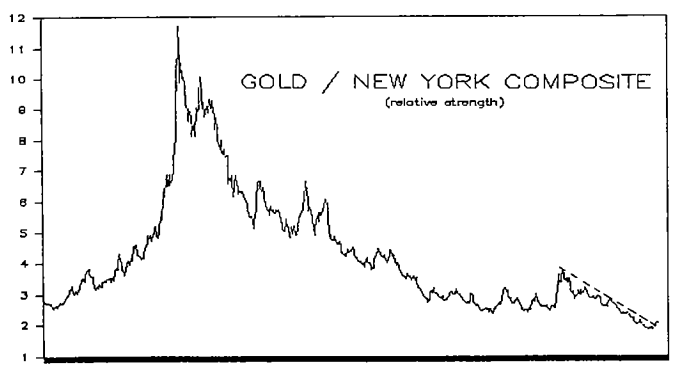
(8) **Gold** has turned decisively bullish. The 65-week moving average of gold stands at 390. Gold has now rallied well above its 65-week MA, which is often viewed as the primary line for gold.











The gold/bond ratio has now turned up in favor of gold. This is normally an inflationary indication.

Gold's momentum line has turned strongly bullish -- see chart on page 2). Note that the momentum low in 1989 was considerably higher than the momentum low of 1985.

The gold/common stock ratio has now turned up in favor of gold. This ratio trending up is not a guarantee of a gold bull market, but if there is to be a gold bull market this is a prerequisite (see page 2 chart).

On a relative strength (performance) basis gold is now outperforming bonds, stocks, and the trade-weighted dollar. This is a fairly new development, and it could have very important implications for world markets and world economies. (Note: the page 2 gold charts are courtesy of Paul Eldridge in conjunction with *The Ruff Co.*).

(9) Since the October 13 market crash, confusion has reigned. Most analysts remain optimistic or at least hopeful. Few are talking about a major bear market. At times like these, my PTI can be a particularly valuable indicator, and the next section deals with the PTI.

PRIMARY TREND INDEX: We've added a lot of new subscribers over the last six months, so this is a good time to explain and review my Primary Trend Index (PTI). I also want to include a bit of background.

After the crash of 1929 and during the Great Depression which followed, people became very disillusioned with the stock market. Oh sure, there was a marvelous bull market during 1932-37 (the Dow increased by 268% during that time), but the public, the excited, "new-era" public of the 1920s, they weren't buying during the 1930s. To a large extent they had been wiped out, destroyed by the crash and its Depression aftermath.

Then came World War II and interest in the stock market continued at a bare minimum. At any time during the 1940s (and I remember this only too well) a 3 million share day on the NYSE was considered a whopper. Wall Street lay largely dormant (at least from the standpoint of volume) during the '40s.

I can remember sitting in a Bache boardroom during the summer of 1949 (the market was open on Saturday in those days), watching that dreadfully dull market, which was largely trading utility stocks. At times the tape would stand absolutely still for as long as a minute. I mean it was SLOW. Except for a handful of us "market nuts," interest in the stock market was low to nonexistent.

All that occurred during the beginning of the fabulous bull market of 1949 to '66. From its low on June 13, 1949 of 161.60, the Dow headed up -- and up -- and up. I remember around 1952 we early investors would shake our heads and wonder whether "the Dow would ever again climb above its 1929 high of 381." Well, of course, it did -- during 1954.

When the Dow finally rose past its 1929 high, that feat triggered the beginning of the public's renewed interest in the stock market. By 1956 the public was becoming increasingly interested in stocks, although the severe reaction in the summer of 1957 cooled off their new-found ardor.

It was during the great rise of 1958-59 that the first indications of massive public participation showed itself. Then during the 1960s volume increased almost yearly, and it was during that period that many advisory services came into being.

I started my series of technical and Dow Theory articles in *Barron's* in December 1958, and I wrote numerous article after that (I think there were 27 articles in all). During that period technical analysis (which had been a "dirty word" during the '40s and '50s) began to develop a following. The following blossomed, and by the end of the 1960s technical analysis was being accepted in polite circles. The Dow Theory, virtually unknown during the '50s and early-

'60s, was gathering a cluster of latter-day "experts," and new market gurus were surfacing like dandelions after a spring rain.

It was about that time that I started worrying about "too many cooks spoiling the broth." Or to put it another way, I was worrying that too many analysts were following the same indicators. I decided to work on an indicator of my own, an indicator that only my subscribers and I could follow. But it would have to be an indicator that by its very construction would put me on the right side of the market and keep me there.

I started experimenting. I tried combinations, new indices, variations, ratios, moving averages, you name it. I spent three years dreaming up and testing new barometers and indicators.

In my research I came to one unshakable conclusion. My "new indicator" would have to be based on the action of the market (as opposed to indices of sentiment, financial, economic, etc.). The reason I insisted on action-of-the-market indicators is that they eliminated all subjective analysis. For instance, if advances are greater than declines on a given day that's a fact. There's no guessing or interpretation there. That fact tells you something definite about what the market did that day.

Working from that premise, I developed an amalgam of eight indicators whose combined actions revealed the underlying direction of the market. I tested this index over three years. The evidence showed that sometimes it led the market, sometimes it was coincident, and occasionally it lagged, but it ALWAYS revealed the underlying correct direction of the market. I called my new indicator the Primary Trend Index or PTI.

I've computed the PTI daily since the late 1960s and I've included a chart of the PTI in every Letter since 1971. I've said this before, and I blush to repeat it, but most of the mistakes I've made in the market over the last 20 years (and I've made 'em) have been in believing that I knew better than my PTI what was happening in the market.

I don't know whether my PTI formula was a lucky guess, a gift from above, a momentary stroke of genius or what -- but it has been a winner over the years. Those who have followed it have been on the right side of the market the vast majority of the time.

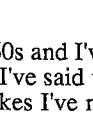
One of the most remarkable characteristics of the PTI (at least so far) is that unlike most technical indicators, it is not prone to whipsaws. As you know, whipsaws can be an expensive glitch in any market system. Those of you who have traded stocks, options, or mutual funds with moving averages know what I am talking about. If you suffer two or three whipsaws in a period of a few months, you can easily lose a third of your capital.

As I say, I don't know if it will continue, but so far my PTI has created very, very few whipsaws over the years. Once the PTI turns up and rises above its 89-day moving average, it tends to stay there until the primary trend turns down. When that happens the PTI will drop below its moving average, and it will stay there until the primary trend turns up again.

Oh yes, one more thing. The PTI is proprietary. I have never revealed its formula. I felt if I did reveal this "secret" that the PTI could gather a following and thereby lose its value.

What is the PTI telling us now? As you can see on the page 2 chart, it's moving sideways, under the recent high but not below its moving average. Stay tuned!

INVESTMENT POSITION: You've heard this from me many times before, but at this point in the game I opt for LIQUIDITY. Money market funds are liquid, cash is liquid, C/Ds from TOP rated banks are liquid, Treasury bills and notes (under two years maturity) are liquid, Deutsch marks, Swiss francs, and Yen (all legal to hold at your bank after January 1) are liquid, gold is liquid.



With breadth indices on the NYSE, AMEX, and OTC falling, this is a good market to lose money. And you all remember Russell's first investment law which states, "Above all, don't lose money."

Those of you (and I hope this means all of you) who followed my advice and policy of monthly fixed-dollar purchases of gold coins must now be ahead, since most of our buying was done in the "bargain under-400 dollar" area. On November 20, the December (literally spot) gold contract pushed over 400 for the first time, and for gold holders this must have felt good. Recommended Lexington Goldfund has pushed above 6.30, and is now looking quite bullish (1-800-526-0056. In NJ it's 1-800-932-0803). Financial Strategic Gold Portfolio is can be reached at 1-800-525-8085. Neither of these gold funds has a load. With apologies to hard-pressed brokers, I almost never recommend a load fund.

Because my PTI has not yet rendered a verdict, I have kept the question mark in the box.

OPINIONS: I met A.J. ("Jack") Frost many years ago, when he asked me to co-author (with him) a book on the Elliott Wave. I begged off the project, but I did suggest that Frost meet a brilliant friend of mine. With that I introduced him to Bob Prechter. That suggestion proved fruitful. Frost and Prechter wrote the authoritative book, The *Elliott Wave Principle,* and, of course, later Prechter started his famous Elliott Wave advisory service.

I haven't seen Jack Frost in many years, but I read about him often, and occasionally I receive a letter from him. I gather A.J. believes there will be one more rise in the Dow prior to a major (and I mean MAJOR) bear market. Here's what Frost says, according to a recent column by Canadian newspaperman Tony Reid: "I think the market is unfolding as expected, and I feel it will peak out some time in 1990 at Dow 3250, although I wouldn't rule out Bob Prechter's original projection of 3400 to 3600. When it peaks next year it will create not just a Black Monday but a whole series of Black Mondays. . . .I expect a severe depression, and one of the worst economic collapses in history. . . . The real estate market in both Canada and the US is very much over-priced and will tumble on the order of 50% to 60% by the mid-'90s. . . . In light of this decline both the US and Canadian dollars will drop sharply in world markets with the result that the Federal Reserve and the Bank of Canada will beef up the money supply to cure the ills of the economy. . . .That will be to no avail because markets tend to follow their own set of laws, and nothing can stop it this time. . . .The purchasing power of the dollar has declined to 5 or 6 cents since 1908, when I was born, and today's dollar will lose the same value between now and the year 2000. That's the reason I feel investors should orient the major portion of their assets to gold and gold-related assets. The DJIA, currently at 2575, will rise above 3000 to 3250 in 1990. Then it will drop to 1700, which will be the first stopping point of any importance. Gold, currently at 371, has bottomed out and will rise to US $1,000 in the next two to four years."

Russell comment: Frost has been remarkably right on the markets ever since I met him many years ago. If he's just as right about the future, the 1990s are going to be a sight to behold -- and to live through!

This is from my friend, Charlie Allmon, who runs Growth Stock Fund (NYSE) and publishes *Growth Stock Outlook*: "Our guess is that the next buying opportunity , maybe in 1990 (or 1991 or 1992), no doubt will be the best you are likely to see for the remainder of this century. We are value players, as you know. Values in 1987, 1988 and 1989 were not sufficiently attractive to warrant the risk inherent in a financial market gone berserk with LBOs, massive debt, a no-brainer recovery in 1989, not to mention the biggest financial bubble ever seen in the USA. . .real estate. . . .We stand virtually alone in calling attention to the big US real estate bubble, which is leaking air and could burst with a loud financial bang any time." Russell comment: You're not alone, Charlie, I've been warning about real estate prices all year.

This following is from old friend, Joe Granville (Oct. 26 Letter). Joe is very bearish now, and he writes: "Way back in the days when I was writing the market letter for EF Hutton between October '57 and August '63, I was repeatedly called into the front office and cautioned not to get too bearish because it was bad for business. I was told always to try to be generally long-term bullish. Now think very carefully about this the next time you listen to a technical analyst who is employed by a brokerage house. Listen carefully and you will hear all the hedge words. They are there for a purpose. The purpose is simply THAT HE WANTS TO KEEP HIS JOB. That is one of the reasons why I left Hutton in August 1963 to start this letter. I feel that right or wrong, subscribers are entitled to an unbiased opinion. I can tell you now that you will never get a completely unbiased market opinion from a brokerage house technician. So with the clear majority of them telling you that they see no problems ahead, THAT IS A CLEAR INDICATION THAT THERE ARE MAJOR PROBLEMS AHEAD." Russell comment: I agree with Joe on this. One of the things that annoys me is FNN's parade of brokerage house commentators. Brokerage house analysts are never fully bearish. As Joe stated, bearish analysts don't last very long at brokerage houses. A broker doesn't make money when the public is on the sidelines, they make money when the public is bullish and BUYING.

If anyone is close to the auto business, it's Chrysler's chairman, Lee Iacocca. Here's what he says (from the Oct. 30 *Automotive News)*: "I've been saying for five years -- and I've got to be right one year -- that the recession is coming. I think we are going to have a downer. If I had to pick a year, I'd pick 1990 as more than a transition year. It's going to be a difficult year."

Iacocca went to Washington a few weeks ago to lay out the difficulties facing the auto industry. He further comments, "They don't know there's a war on. They don't have the foggiest idea. If I take all the GM and Ford plant closings and all of ours for six months, I can show how difficult this business is. Am I saying the worst is yet to come? I don't think we've bottomed out yet. That is what I am saying.

"You have too much capacity chasing too few customers in the richest market in the world. It will only be solved one of two ways. The way we will probably have to do it is that GM, Ford, and Chrysler will have to close down some plants. Period." So that's the world as Lee Iacocca sees it. and remember, they don't pay the CEO of Chrysler to be a pessimist.

Doug Casey writes a most interesting report entitled *Investing in Crisis* (824 E. Baltimore St., Baltimore, MD 21202). Doug is one of the more literate and intelligent writers, and I always read him with great interest. This is from his most recent letter: "Ten years. What have I learned? I just wish I knew then what I know now, and I hope that 10 years from now I don't have any strong feelings about the subject. One thing I've taken to heart is the importance of conservation of capital. By following my own more speculative advice, and with fairly sizeable amounts in most cases, I've gone on a wild financial roller-coaster ride. It's been great fun, and I can't complain about the results, because I've been consistent, which is critical. And one long ball, ten-for-one homer does make up for nine strikeouts. But as you get older, you're more worried about keeping what you have than in doubling it."

Russell comment: Doug is talking about Russell's First Investment Rule which states, "Above all, don't lose money." Conservation of capital is absolutely crucial in this business. If you're 25 and lose most of your capital, it's a shame and a learning experience. If you're 65 and lose most of your capital, it's an outright disaster, and it's a lesson you should have learned 40 years earlier.

BUYING POWER, SELLING PRESSURE: I follow many market studies, all of which gauge the forces of supply and demand. These include the major stock averages, the advance-decline ratio, daily new highs and new lows, my own Primary Trend Index, my own DowPow, and the Summation Index (see last Letter). One of the most valuable, however, is *Lowry's Buying Power and Selling Pressure* (701 N. Palm Beach, Palm Beach, FL 33408).

The Lowry studies began in 1938, and I have been following them since the 1950s (although I seldom mention the studies in these reports). The Lowry studies aren't the slightest bit interested in economic fundamentals. Lowry deals strictly with the forces of supply and demand in the market. Lowry measures supply with a buying power line (the line is a moving average based on the daily price and volume of all rising issues on the NYSE). Lowry measures selling with a selling pressure line (based on price and volume in declining issues).

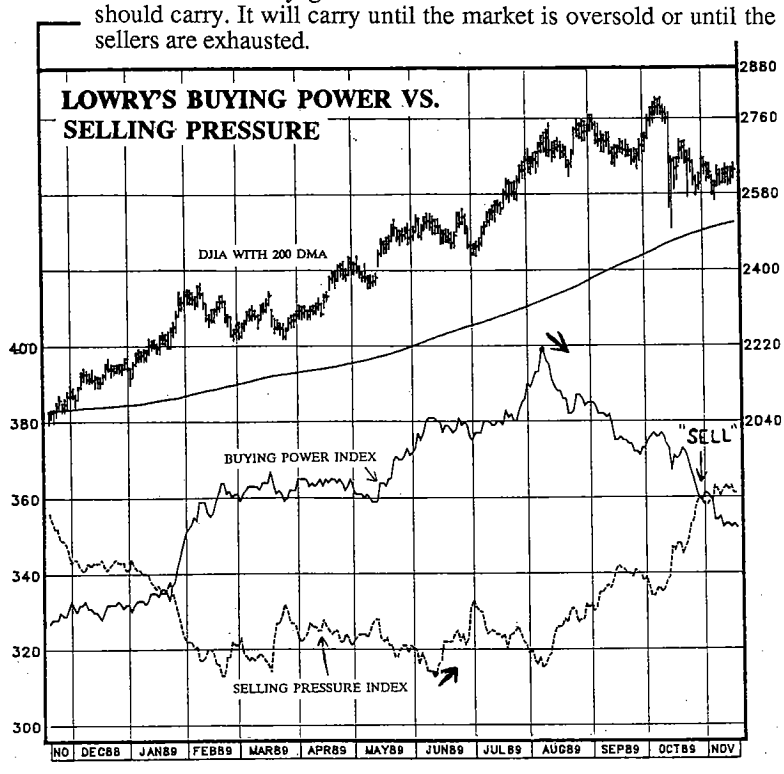
The pattern of the Lowry buying power (BP) and selling pressure (SP) lines can tell a lot about the market at any given time. Note on the chart below that in late-January 1989 BP moved above SP. This constituted a bullish mode for the stock market from the Lowry standpoint.

Now note that SP hit its low in June, then started an irregular upward course. Once SP hits a low and turns higher, it generally continues higher until at some point in the future SP overpowers (moves above) BP. At the point where SP overpowers BP, a Lowry major sell signal is generated.

SP almost always turns up before BP tops out. This is true because at some point a rising market always attracts profit-takers. But profit-taking alone does not mean that a market is topping out. To top out, BP must exhaust itself and turn down, and then SP must overpower BP.

Note that in early August BP hit a peak and turned down (all during that period SP continued to rise). That's the distribution phase. Two weeks ago the two lines crossed, with SP moving above BP. That action constituted a major sell signal.

As this is written the Lowry studies are in the sell mode, even though the market has rallied. When the current buying spate has run itself out (and with the SP line dominating), the market should head down. Lowry gives no indication of how far the decline should carry. It will carry until the market is oversold or until the sellers are exhausted.



NOTES & QUOTES: Sears has been unable to sell its Sears Tower, and the word is that it will now try to take out an $815 million mortgage on the property. The word is that the Japanese were interested in buying the Chicago tower, but word came down from the Japanese government to back off because of feared political backlash if the tallest building in the US was to go on Japan's trophy shelf (did you know that Sumitomo Life Insurance spent $300 million to buy the IBM Tower in Atlanta?).

* *

How have the junk bond funds fared this year? As of Nov. 14, 84 junk bond funds provided a total return (interest plus appreciation or decline) of 0.84% (from *Lipper Analytical Service*).

* *

The best politicians money can buy. Here's where S&L chief, Charles Keating's money went: $1.36 million to US Senators, $114,000 to US Congressmen, $22,000 to national parties, $51,250 to Arizona officials, $83,570 to Arizona gubernatorial candidates, $41,000 to Calif. gubernatorial candidates, $119,000 to Phoenix county offices.

* *

Massachusetts miracle? The Mass. state budget deficit is now projected at $721 million with some estimating it to hit NY state's deficit of $1 billion. The Mass. credit rating has now fallen to the lowest in the nation, tied with Louisiana.

* *

I just received a letter from famed writer Arthur Hailey (he lives in Nassau, Bahamas where the water is lovely and warm). Here what he says: *Am continuing to enjoy your newsletter. Your philosophy alone -- which I greatly admire and agree with -- is worth the price of subscription. I've a new book coming out soon -- on my 70th birthday. See enclosed. All best, Arthur.*

The new book, entitled "The Evening News," is scheduled for April 5, 1990. You can bet it will be a best-seller (as are all the Hailey books).

* *

The drug plague is proving to be an almost insurmountable problem for the states. In the 1950s and '60s the pressing need in public construction was for school buildings. In the 1990s, it will be **prisons.** The state of Georgia is an example. The state's prisons now hold 19,900 prisoners. But 15,000 new prisoners will arrive this year. Four out of every five crimes in Georgia are drug-related. The state's prisons are so overloaded with drug crimes and so crowded that thousands of felons are let off with little or no prison time. Throughout the state 135,000 men and women are on probation even though many of them should be serving time. Georgia's Organized Crime Council states that illegal drugs in the state are now a $7.5 billion business. Many public and private figures cry for more drug arrests. But the real story is that nobody knows where to put all the new felons.

* *

You hear a lot of talk about Japanese financial power, but I don't think many people realize what is happening. This is from *Donaldson, Lufkin & Jenrette:* "A few months ago the Bank of Japan announced that personal savings had risen to $5.104 trillion at the end of the 1988 fiscal year. That translates to savings per average household of $126,000, and the growth of these savings has been in double-digit figures for each of the last three years despite strong increases in consumption. The size of the leading Japanese banks which has shot by ours in terms of total assets also stretches the imagination. What is now the largest bank, Dai-Ichi Kangyo, had year-end assets of $387 billion -- $100 billion more than the consolidated assets of the entire US Federal Reserve System." Breath-taking enough? *Fortune* magazine, in its current "Pacific Rim Special Edition," lists the top Japanese banks. Dai-Ichi Kangyo with assets of $379 billion, Sumitomo with assets of $363 billion, Fuji with assets of $360 billion, Mitsubishi with assets of $348 billion, and on and on. I calculated the combined assets of the top 10 Japanese banks. The figure came to $2.93 trillion. In contrast, the assets of the top 10 US banks comes to $859 billion, less than a third of the assets of the big Japanese banks!

* *

Social Security: Call it what it is -- a tax, pure and simple. Mull this over. *After a lifetime of contributing to SS receiving lower wages because of the requirement that employers pay matching sums, an American retiring in 1987 can expect a* ***maximum*** *retirement benefit of $1,380 per month or $16,560 per year. Of course, with the mysterious ways SS officials figure retirement benefits, very few retirees receive the maximum, regardless of their "contributions." And recall too that if a SS recipient decides to work to supplement that income, his or her SS benefit will be cut $1 for every $2 earned above the maximum of $8,000 per year.*

What would those same dollars have bought in the private market of retirement plans? Please don't choke, but a straight life annuity (purchased with the same SS contributions) from the Baltimore Life Insurance Company would provide a comfortable monthly income of ***$8,712*** *or $104,551 a year! That's about six times the maximum SS benefit!*

Now consider the bad news. There's no SS Trust Fund, as our leaders are fond of referring to the fraud. The money you and your employer pay to SS goes into the federal general fund, exchanged for special Treasury IOUs that can't be sold on the open market. It's as if GM funded its employee retirement plan by writing up IOUs on GM bonds and depositing them in the retirement account. Any corporation official who did that would be facing jail city. But federal officials can do it openly with your SS funds. Then there's the really bad news. Federal courts have held that you really have no entitlement to SS retirement benefits. You have no contract for retirement under SS. You are entitled only to what the SS officials decide you should receive, if anything. (All the above courtesy of *Amer. Institute for Economic Research,* Gt. Barrington, MA $19 per year.)

* *

With the Berlin Wall down, it is only a matter of time before we have a Germany that is economically united. What are the implications of the coming "super-Germany"? (West) Germany, already the world's largest exporter, will be the central economic entity in the new Europe. Germany will (with Gorbachev's blessings and encouragement) invest heavily in the Soviet Union. There will be pressure for a US troop pull-out from Germany. Thousands of Turkish workers will be ushered out of West Germany -- they'll be replaced by East German workers. Gorby, working furiously to bring the Soviets into the 20th century, will be betting that he will be able to control the new, united Germany.

* *

An old high school buddy of mine, Don Morris, publishes the syndicated *Donald R. Morris Newsletter* (PO Box 19909, Houston, TX 77224, $50 a year). It's an extremely informative letter. (Morris in an Annapolis grad, spent many years with the military and the CIA, and he knows his stuff.) This is from a current letter: *The Western military establishments have lost their raison d'etre; Gorbachev has made it appallingly clear the Soviets cannot maintain their end of the balance. If there is a confrontation between East and West, it is no longer military, but economic (or will be as soon as the Soviet Union has an economy to do any confronting with). Future warfare (and there's going to be a good bit in the next few generations) will be conventional, generated by the rising tide of national and ethnic chauvinism in the Third World, and by the break-up of the Marxist structures.*

It is now necessary to profoundly restructure our military posture, and by the nature of the beast, this will be no easy task. It is still a little early to start dismantling our nuclear capacity -- for openers, while Gorbachev is sincerely determined to engineer an almost total Soviet nuclear disarmament and a major conventional disarmament as well (unilaterally, if necessary) nothing much has happened yet. Gorbachev is facing exactly the same problems an American administration will face when the job finally starts.

But it will start. There simply aren't going to be any B-2 stealth bombers, any MX missiles, or SDI, and precious few big ticket items (even if they still were necessary, we can't afford them). George Bush has been accused of "failing to respond to Soviet overtures;" there is as yet no need to, but there will be soon, and it is indeed a time for great caution.

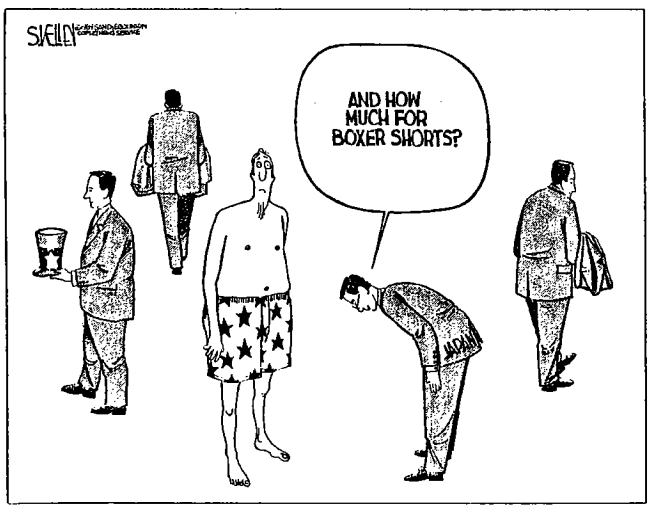
Make no mistake; in a quarter of a century -- tomorrow in military planning -- our military establishment will bear little resemblance to

our current one. It will be smaller, far less expensive, oriented to brush-fire conventional warfare, with a modest nuclear capacity -- the MAD balance, theoretically, can be maintained with two ICBM missiles. The nuclear Triad, a land, sea and air capacity -- will lose a leg or two (the Navy's leg will be the sturdiest), our NATO ground forces will shrink to symbolic units, and SAC will be a pale shadow of its present shape.

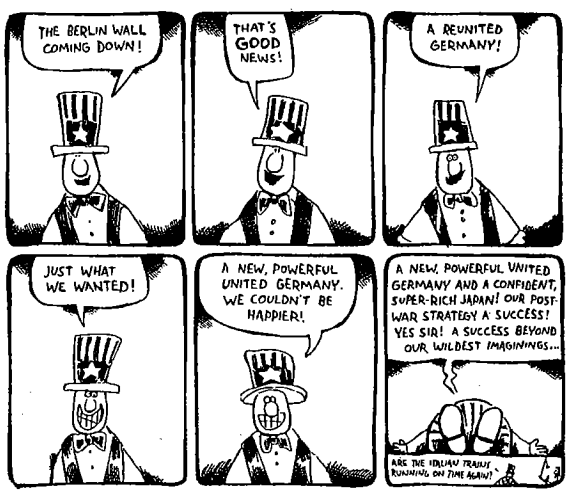
Russell comment: These are extraordinary predictions, but I happen to agree. There's a new, smaller military world a'coming. Get ready for it. Economics, not the military, is the true wave of the future.

I couldn't resist including this cartoon by our own (*San Diego Union*) Steve Kelly. Everybody's complaining that the Japanese are buying up America, but when you think about it, what else are they going to do. The Japanese have a positive trade balance with the US of roughly $50 billion. The US doesn't make a heck of a lot of things that the Japanese want. So the Japanese buy properties. The fact is that the British and Dutch own more US facilities than the Japanese do, but the Japanese like prime properties. And we did fight them during WW II, so it's sort of embarrassing to see a nation we defeated now defeating us economically.

* *



And just for good measure, here's another cartoon (do we laugh or cry over this one?).


THE BERLIN WALL COMING DOWN!
THAT'S GOOD NEWS!
A REUNITED GERMANY!
JUST WHAT WE WANTED!
A NEW, POWERFUL UNITED GERMANY. WE COULDN'T BE HAPPIER!
A NEW, POWERFUL UNITED GERMANY AND A CONFIDENT, SUPER-RICH JAPAN! OUR POST-WAR STRATEGY A SUCCESS! YES SIR! A SUCCESS BEYOND OUR WILDEST IMAGININGS...
ARE THE ITALIAN TRAINS RUNNING ON TIME AGAIN?

* *

Counterfeiting is increasing in the US. One problem for the bad guys is the "paper." US bills actually have no paper in them at all -- they're 75% cotton and 25% linen, and examining the paper is one way of catching a phoney bill (only one company makes this "paper" and it's illegal to reproduce it). But some counterfeiters (get this) bleach out dollar bills and overprint them with the counterfeit designs! The Bureau of Printing and Engraving uses 65 separate automated steps to manufacture the currency. All steel plates are engraved by hand. A different person engraves each plate, so no one person knows how to engrave an entire plate. A secret formula ink is used, and the printing is done by a complicated process using both typographic and intaglio processes.

GOLD, METALS: Many of the new developments in gold were discussed in the early part of this Letter. Why is gold going up? Does it matter? Well, yes, it does. One theory -- the US economy is sinking, and the Fed is facing a dilemma: ease up or take the pain of recession. If history means anything, the Fed will ease. "If the Fed pumps the dollar slumps." When that happens (and it seems to be happening now), inflation should pick up, but even if it doesn't a weak dollar would fuel a gold rise. At this point gold may simply be reflecting the above.

There's another possibility that is much less obvious. The Soviets are short of food, very short. So far Gorbachev's new freedom has failed miserably to produce better Soviet living conditions. And the demand throughout the USSR is building for action and an end to the long lines for food. What does all this spell? It almost surely spells forthcoming major Soviet buying of Western foodstuffs (grains).

According to *Commodity Information Systems* (PO Box 690652 Houston, TX 77269), "World grain reserves are expected to fall for the third consecutive year during 1990. At current consumption rates, reserves are forecast at 66.4 days supply. This will be the tightest world supply of grains in 14 years and represents a dangerously low level of reserve stocks. If farmers fail to expand production to new record levels during 1990; if drought reduces yields in any major producing country during 1990; if political or financial chaos lead to lower production in a major producing nation during 1990; or, if living standards improve and better diets are demanded by consumers. . . a food shortage of major proportions will be a distinct possibility!"

If the above is correct (and I have no reason to believe that it is not) then we could be facing a major bull market in foods. That would be inflationary -- very.

When the short interest figures were released on November 21, I immediately turned to the gold stocks. Here's what I found. ASA shorts increased in the latest (monthly period) from 288,000 to 495,000. Battle Mtn. from 146,000 to 212,000. Homestake from 417,000 to 503,000. Lac Minerals from 405 to 128,000. Newmont Gold from 112,000 to 312,000. Placer Dome from 192,000 to 466,000. These statistics represent a jump of 83% in the NYSE gold share short positions! What's happening? The speculators are fighting the new primary bull market in gold. There's nothing more bullish that a new bull market that is disbelieved -- **and the surging short interest in the shares is proof that the new bull market in gold is DISBELIEVED. Disbelieved -- it's more than that. The speculators are lining up to bet against it.**

I assume (well, I hope) that all my subscribers have been buying gold coins bought at lower price levels. For gold stocks, you might buy any of the above listed shares on a pullback.

LATE NOTES: My PTI, after establishing a record high of 3289 on Oct. 10, dropped to a Nov. 6 low of 3247 (page 2 chart). Since then the PTI has advanced steadily, and is now within shooting distance of the Oct. 10 high. The critical 89-day moving average of the PTI was never close to being violated. Until it is -- the PTI remains in the bullish mode.

From a Dow Theory standpoint the picture is a lot less appetizing. The problem is the Transportation Average which is still almost 300 points under its 1989 high of 1532.01. A new Dow high would therefore provide an almost guaranteed non-confirmation.

NEXT MAILING: Dec. 13